

services are unevenly distributed within and across the States, and reach just a small percentage of eligible individuals. In the words of Howard Dean, the Governor of Vermont who also happens to be a physician and who recently testified on Capitol Hill on behalf of the National Governors Association, "We can provide a higher quality of life by avoiding institutional services whenever possible. . . . We will still need quality nursing home care for the foreseeable future, but we can maintain the necessary level of needed nursing home care while growing home and community based services if Congress will give the States the tools."

The MICASSA bill is precisely the tool both the States and consumers need to obtain more cost effective long-term services in the most appropriate setting for the individual. Instead of creating a new entitlement, MICASSA makes the existing entitlement more flexible. It amends Title 19 of the Social Security Act and creates an alternative service called Community Attendant Services and Supports. This allows individuals eligible for Nursing Facility Services or Intermediate Care Facility Services for the Mentally Retarded, regardless of age or disability, the choice to use these dollars for "Community Attendant Services and Supports."

These attendant services and supports range from assisting with activities of daily living, such as eating, toileting, grooming, dressing, bathing and transferring, as well as other activities including meal planning and preparation, managing finances, shopping and household chores.

Quality assurance programs, which promote consumer control and satisfaction, are also included in this bill. The provision of services must be based on an assessment of functional need and according to a service plan approved by the consumer. It also allows consumers to choose among various service delivery models including vouchers, direct cash payments, fiscal agents and agency providers.

Some have argued that such a flexible and consumer friendly option would bring people who need these services "out of the woodwork" and make our Medicaid costs skyrocket. This bill has been put together based on what we have learned from pilot programs and best practices throughout the States. Oregon and Kansas have data to show that fear of skyrocketing costs is blown out of proportion. While there may be some increase in the number of people who use this option at first, savings will be made on the less costly community based services and supports, as well as the decrease in the number of people going into institutions. The bill also allows states to limit the total amount spent on long-term care in a year to what the state would have spent on institutional services.

Whether a child is born with a disability, an adult has a traumatic injury or a person becomes disabled through the aging process, we can and must do better in offering our citizens the kind of long term care services they need and deserve. I can think of no better way to honor the memory of our departed disability rights leader, Justin Dart, who died on June 22nd and was known by many as the father of the Americans with Disabilities Act than to support passage of H.R. 3612.

INTRODUCTION OF THE NATIONAL DEFENSE RAIL ACT

HON. JULIA CARSON

OF INDIANA

IN THE HOUSE OF REPRESENTATIVES

Friday, July 26, 2002

Ms. CARSON of Indiana. Mr. Speaker, I rise today to talk about the important issue of passenger rail in America, and the future of Amtrak.

The passenger rail system suffers from gross neglect of our investment.

We have actively engaged in financing, developing, and preserving the infrastructure of all other modes of transportation. Whether bailing out the airline industry, federally funding and fixing the interstate highway system, or subsidizing airport construction.

It is imperative that we build a world class passenger railroad system in the United States. We cannot wait for highways and airports to become so overwhelmed that they can no longer operate, and we cannot continue to hold the millions of Americans who rely on rail service in limbo while we refuse to provide Amtrak with adequate funding.

This is why yesterday I introduced H.R. 5216, the National Defense Rail Act, which will mirror legislation introduced by Senator ERNEST HOLLINGS.

This legislation provides a blueprint for the future of passenger rail in the United States. The bill will help develop high-speed rail corridors, long distance routes, short distance routes, security and life-safety needs, and will provide Amtrak with the tools and funding it needs to operate efficiently.

Mr. Speaker, we consider subsidies to airlines and roads be worthwhile investments in our economy and our quality of life. We must make the same investment to create a world-class passenger rail system in order to see the same kinds of benefits.

I urge my colleagues to join me by cosponsoring this bill, and show your support for a strong national passenger rail system.

CORPORATE ACCOUNTABILITY HEARING

HON. RICHARD A. GEPHARDT

OF MISSOURI

IN THE HOUSE OF REPRESENTATIVES

Friday, July 26, 2002

Mr. GEPHARDT. Mr. Speaker, I submit the attached document, which is the transcript of the corporate accountability hearing conducted by Members of the House of Representatives, for printing in the CONGRESSIONAL RECORD.

OPENING STATEMENT BY HOUSE DEMOCRATIC LEADER HON. RICHARD A. GEPHARDT

Mr. GEPHARDT. Thank you all for being here. If I could, I would like to make an opening statement, and then we will get to our first panel, with appreciation for all of our panelists for their time and effort to be here with us today for this important hearing.

We are honored to have with us today some very talented and special guests, an all-star team of experts on the issue of corporate accountability and responsibility that has become one of the most important issues in our country.

I think many of us are tired of the old left-right political debates because, to my mind,

the issue before us is not about politics but about what's right for our country and how to restore people's trust and faith in our economic institutions. This is a discussion about enacting strong safeguards that will protect investors, protect consumers, and move every American forward with an agenda that gives everyone a chance to succeed. We need to apply our values to governing. Our values tell us that accountability and responsibility must be operating principles in our markets, especially for the corporations that form the bedrock of our capitalistic system.

Sensible rules that enable our companies to function effectively will grow the economic pie for every American taxpayer and every American family. Too many times in the last 7 or 8 years the special interests and extremist voices that would like to get rid of almost all regulations have triumphed in the face of common sense and the sentiment of the majority of the American people. Too often these voices have had a real and, I would submit, destructive impact on our laws and our economic health.

So today we are here to listen and to learn, not simply to what went wrong but, more importantly, to figure out how to make it right.

Democrats in Congress have spent months seeking solutions to this crisis, and we are prepared to go to any part of this country to figure out what happened, why it happened, and the best way to fix the problem.

This week, as you all know, the Senate unanimously passed—and I'll say it again, unanimously passed, and that's a rare occasion—a crucial bill that would attack the current crisis of confidence. The Sarbanes bill would bring about structural changes in our auditing system, making sure that audits are objective and independent, while imposing stiff criminal penalties on bad actors and actresses.

We in the House have been working for months to pass a strong initiative that would also protect people's pensions and restore investors' faith. We have offered a financial services bill, a criminal penalties bill, and an offshore tax havens bill as part of a much more comprehensive business Investors' and Employees' Bill of Rights.

Unfortunately, the leadership in the House in the Republican Party—and, therefore, the leadership—has blocked these proposals. We have faith that these problems can still be fixed. We have the most ingenious entrepreneurs, the brightest minds leading our way to innovation. And we have the hardest working, most resilient, most resourceful people on the face of the Earth. And for that, we are all grateful.

And today we pledge to continue to work together in order to do what's simply right for the people that we all represent.

We thank our guests, and especially my brave colleagues in the Congress who every day speak up for the American people and who helped build this country into the greatest nation that's ever existed.

PANEL 1: PENSIONS, WALL STREET AND CORPORATE FRAUD

Mr. GEPHARDT. I'd like to introduce our first panel.

What can I say about Eliot Spitzer. He was at this a long time before any of us were focusing on these problems of corporate abuse and accountability. At the State level, he helped to launch a national reform effort to close loopholes and to hold people who don't play by the rules accountable.

The same goes for Richard Moore, State Treasurer in North Carolina. Richard Moore has worked hard to protect the pensions of all the people in his State. He's understood the fundamental truth, that without transparency and clear rules of the road, our investors get hurt, employees suffer, and our

economy does not reach its potential. We're lucky to have him with us today, and we thank him for coming.

Finally, William White is the CEO of WEDGE Group, an investment firm based in Houston. He's been a private executive elsewhere. He served in the Clinton administration as Deputy Secretary of Energy. He has a broad range of experience that he brings to the table in both the private and public sector, and we look forward to having the perspective of someone with considerable experience in both private and public life.

I am surrounded by many of my colleagues, who I have enormous admiration for. All of them have been deeply involved in all of these issues of trying to increase responsibility and accountability. And I would like to be able to have the time here today to have them all make an opening statement, but I know our guests are on a short time leash, so we're going to go right to our testimony. And then we'll open this up for some questions.

Attorney General Spitzer, would you lead us off? Thank you for being here.

STATEMENT OF ELIOT SPITZER, NEW YORK
STATE ATTORNEY GENERAL

Mr. SPITZER. Thank you, Congressman Gephardt, for that kind introduction, and thank you for your leadership in protecting small investors and the integrity of our financial markets.

Investors must often rely on the judgment and good faith of others to assist them as they make their investment decisions. They rely on the research and recommendations of their brokers. They rely on the judgment of the executives running the companies in which they invest. And they rely on independent auditors to ensure that they are receiving an honest accounting of those companies' profits and losses.

During the past few months, many investors have learned that their trust was sorely misplaced.

Research analysts recommended stocks to investors even as they knew those companies were poor investments. Corporate executives cooked the books to enrich themselves at the expense of their shareholders. And accountants who were supposed to provide an independent audit and review of those books and accounts disregarded their duty in search of greater fees from the companies they were auditing.

Our Nation's economy has been the engine that has brought unprecedented wealth to millions of Americans and their families. Our free market system which allows businesses and entrepreneurs to flourish without excessive government regulation and intervention is unrivaled anywhere in the world.

But our great economic engine is fueled by a belief that the market participants play by the rules. As companies compete in our free market, we have required them to operate within certain boundaries delineated by carefully articulated rules, standards of conduct, and disclosures. And if those rules cease to address the realities of an evolving marketplace, or if they're easily exploited, we must put into place new rules that prevent the exploitation of investors.

Throughout our economic history, we have been willing to implement new marketplace rules to address investor concerns. And the lesson that history teaches us is that new rules furthered our economic interests.

In the early 20th century, when trusts were exploiting the marketplace and undermining the ability of the markets to function, Teddy Roosevelt responded with new rules that restricted the ability of trusts to function. As he said then, "We draw the line against misconduct, not against wealth."

And a few decades later, when massive stock market fraud drove investors from the

marketplace, we responded with the formation of the Securities and Exchange Commission and the implementation of the Securities Act of 1933 and the Securities and Exchange Act of 1934.

The role of government is properly to define the boundaries and rules of fair play in the marketplace. And especially at moments when the rules appear to be broken, government must step back and evaluate the rules themselves. As important as punishing those who break the rules is ensuring that the rules themselves are properly structured.

With that framework, I want to discuss some of the specific proposals that have been advanced by both parties and to talk about how a national market must respond to the challenges that arise when its rules no longer provide the necessary protections sought by investors.

It has become increasingly apparent that the Democratic congressional proposals recognize the structural flaws that have been allowed to develop in our marketplace and offer meaningful reforms that would protect small investors. The Republicans' response has been to ignore and deny the true scope of the problems and to measure any reforms by their distance from current practice, rather than their proximity to appropriate standards of behavior.

Today, the Republicans in Congress are accepting deviancy in the markets and are willing to define marketplace standards by what has become common practice instead of by what is good practice. Hundreds of investment bankers have said to me: "Market pressures force us to the lowest common denominator. We will feel compelled to sink lower and lower in our behavior unless government defines standards for us." That is the proper role for government and the proper response to market pressures that will otherwise define deviancy down.

The difference between the Democratic and the Republican approaches is perhaps best illustrated by comparing the competing responses to my office's investigation that uncovered Wall Street analysts too often recommend companies to investors based on the investment banking fees that those companies generate instead of the underlying investment value.

Our investigation revealed that Merrill analysts writing stock reports function as sales representatives for the firm's investment bankers, using promises of positive research coverage to bring in new clients and stock offerings. We uncovered evidence demonstrating that a key factor in setting annual compensation for analysts was their success in generating or facilitating the generation of investment banking fees and not the accuracy of their buy/sell recommendations to the public.

While our investigation in New York is still ongoing, it is fair to say that these practices were not unique to Merrill Lynch. In response to concerns about the conflicts of interest driving research analyst recommendations, Congressman LaFalce proposed a substitute to H.R. 3763 which would require analysts to be evaluated and compensated based on the quality of their research and would insulate analysts from the demands of the investment banking business.

In short, the LaFalce bill would ensure that analysts serve their true clients, the investors, not the investment bankers.

The Republican bill, sponsored by Representative Oxley, does not require the investment banks to change their practices but merely directs the kinder and gentler Securities and Exchange Commission to study the issue and report back, and the SEC that has already dawdled and stalled, hesitated and malingered.

The refusal of the Republican majority to address the investing public's concerns about

the conflicts infecting the research recommendations that they receive will simply result in the public's hesitation to reenter the market. That will damage our markets, damage the companies that turn to the capital markets for financing, and delay if not deny the economic turnaround that we so desperately need.

Beyond a failure to act, the House Republicans have been actively critical of my office's efforts to crack down on analyst conflicts of interest. Indeed, Congressman Oxley has attacked my office's efforts, charging that I have "burned investors in Merrill," who have seen Merrill Lynch's stock price fall.

Congressmen Oxley and Baker publicly stated in a letter to all attorneys general that if investigations such as mine continued, they would introduce legislation that would prohibit State regulators through law enforcement officials from seeking substantive relief from investment bank analysts who continue to mislead the investing public. Such an amendment circulated in the Senate during consideration of the Sarbanes bill and could still become a matter that could be brought up in the conference committee.

Let me state very clearly that State enforcement of securities laws is absolutely crucial to protecting the investors' rights in the marketplace. Preempting State activities in this area, removing the cops from the beat, would further undermine investor confidence.

I will also note in passing the supreme irony of having the so-called States rights advocates crafting amendments that would restrict the ability of State regulators and law enforcement officials to address wrongdoing in their States.

For years, the Republicans have invoked principles of federalism as they rallied for a smaller, less active Federal Government and advocated for the devolution of power from the Federal Government back to the States. But now that the States have begun to vigorously exercise the powers handed to them, Republicans have undergone a devolution evolution and want their powers back.

The Republican supporters of these anti-State amendments pay lip service to the need for uniform Federal standards governing our securities markets. Congressman LaFalce, in his legislation, has proposed just such a standard, one that will go a long way toward ensuring that the advice that investors receive is advice that is in their best interest.

And so I say to the Republicans in Congress: You have asked for uniform standards. Congressman LaFalce has proposed a uniform standard. You should enact the LaFalce legislation.

Analyst conflicts are only one part of the problem. The collapse of Arthur Andersen and Enron and the massive overstatement of earnings at Global Crossing, WorldCom, and other corporations demonstrate the need for new rules of corporate governance and new standards for the accounting industry.

The Sarbanes bill would require accounting firms to return to their roots as auditors and separate their auditing function, where they stand at arm's length from their clients, and their consulting practices, where the client's interest is paramount.

Finally, the corporate reporting scandals illustrate that too many public companies are placing the interests of the executives who run the companies before the interests of their shareholders and employees. The decades' long shift of power from shareholders to CEOs created an era of the imperial CEO so dominant that neither boards nor shareholders could really control either executive compensation or decision-making.

It is time to restore to boards and institutional shareholders the obligation of serious participation in corporate governance. We need to insist that public companies report results that reflect reality and not clever gamesmanship, and that allow investors to understand their true financial position. And we need to strictly punish corporate executives who falsely certify their companies' financial statements.

These reforms are not only vital to the integrity of our markets, they are necessary if we are going to achieve the economic recovery that we all seek. Taken together, the reforms we are discussing today will signal to a disenchanted and distrusting public that we will no longer tolerate the betrayal of trust. These reforms will tell investors and stockholders that the markets are governed by rules, and those rules are geared to protect their interests.

The immediate goal must be passage of the Sarbanes bill without allowing Republican Members to water it down in the conference committee. But once that is accomplished, there is still much more work to be done, much of it embedded in Congressman Gephardt's Investors' and Employees' Bill of Rights. Congress must address the conflicts created when research analysts are required to service their investment banking colleagues instead of the investing public.

The Securities and Exchange Commission has failed to act on analysts' conflicts of interest. And in his speech last week, President Bush indicated his support for the SEC's weak rulemaking in that area. It is now up to Congress to mandate that analysts who claim to serve the investors' interests actually do so.

We are now at a crossroads. Democrats have recognized how far the standards of behavior have deviated from what used to be accepted norms and have proposed reforms to raise those standards. We must continue to fight for real reforms that will raise the standards governing the conduct of analysts, accountants, and corporate executives. And we must continue to battle attempts to accept fraud and irregularities in the marketplace.

Thank you for the invitation to appear here today.

Mr. GEPHARDT. Thank you, General, very much, for a very cogent and well put together statement. We appreciate it. We'll come back with questions in just a moment.

Richard Moore from North Carolina, we're pleased to see you here, and you can carry forward.

STATEMENT OF RICHARD MOORE, NORTH CAROLINA STATE TREASURER

Mr. MOORE. Thank you, Representative Gephardt. And I would also like to start out by saying hello to Representative Watt and Representative Etheridge from North Carolina. Thank you all very much for this chance to be here.

I come before you today as North Carolina's elected guardian of the State Treasury and the sole trustee and fiduciary of \$62 billion in public funds, most of which is represented by the pension funds of 600,000 active and retired public workers in the great State of North Carolina.

Before I get into specific points, two general points to put this situation into context:

In my prepared remarks, I have several quotes, starting with Alexander Hamilton, George Washington's first speech to the Congress, Woodrow Wilson, and Teddy Roosevelt. All of those go back to make the simple point that we as Americans have always understood that a free market is not the best market in the truest sense of the words. We have always sought to make sure that our

markets were bridled in the name of fairness. And this is something that has been a bipartisan issue. It's been understood since the founding of this republic.

The second obvious point that I believe needs to be made—and also, I must take just a second here of personal privilege. I'm a big student of history, and we always seem to go in cycles. The last time we had a tremendous loss of confidence in the public markets was the Great Depression. And the Great Depression brought about the passage, as my good friend Eliot Spitzer has already recited, of the Securities acts of 1933 and 1934, and the passage of the Glass-Steagall Act. I'm extremely proud that my grandfather, Frank W. Hancock Jr., as a business-oriented member of the House Banking Committee, played a significant role in drafting and championing many pieces of the necessary reforms.

The second general and obvious point, but a point that I really think that this body needs to make in the next couple of weeks, is to remember that we are addressing regulations that apply only to public companies. And I want to say that again because it's so obvious that it's missed: They apply only to public companies, and no one forces a company to become public. The choice to do so means that its corporate leaders voluntarily give up some of their autonomy and agree to be regulated. The tradeoff, which has been incredibly significant over the last 20 years, is that those companies may have access to capital at an incredibly discounted rate, which has been a wonderful thing for everyone.

But even today, most businesses in America, those located across the Main Streets that you all represent, are not publicly regulated. And when they need additional capital for their businesses, they pay a premium for it. It's an obvious point, and one that I think needs to be stressed more.

The conclusion is that publicly traded companies have been and must be regulated to make sure that the individual investor, who I am here to represent in a large way today, but the individual investor can properly value his or her risk before an ownership decision is made. This, again, is an obvious point that has been overlooked by those who are afraid that additional government regulation will foul the market.

Who is the stock market today? The stock market is representative of 80 million Americans who have decided to take part in these public markets. Either directly or indirectly through mutual funds and other pension plans, they have placed their hard-earned savings in these marketplaces. And that in itself is remarkable.

They have been enticed—and I will use that word again—they have been enticed through tax policy and professional advice to participate and share in the American dream.

Now, it is not your job, nor is it the job of corporate America, to ensure that that dream comes true. However, it is your job to make sure that the marketplace is fair to all so some don't profit and others lose from the exact same investment—from the exact same investment.

Our markets today hold about \$12 trillion in assets; \$2.2 trillion are held in pension funds like the one that I run. Approximately \$8 trillion in the marketplace is controlled by mutual funds. And what a lot of people don't realize is most pension funds are the largest clients of mutual funds. So we have tremendous clout in the marketplace, clout that I don't think that we have learned how to use yet, and we're not equipped at this point to do it.

The reason for that is that institutional ownerships have evolved over the last 30

years. As a result, we as institutions find ourselves collectively the largest single shareholder in virtually every major company in America. The founders of those companies, or the founders' descendants, in many instances are no longer seated around the board tables advocating in their own self-interests for the rights of the shareholders.

It is truly today often a setting like government, the arena that we all work in, where people spend other people's money.

We, as institutional owners, must act like the owners that we have become. However, we cannot do it alone. We need your help. We need Congress and the administration to make sure that we can properly exercise our prerogatives of ownership. We need your help to make sure that we can tell whether the interests of management and shareholders are properly aligned. We need your help in making sure that we as investors can properly price risk. We need your help in making sure that the cop on this particular beat has the resources and tools to do their job.

We need your help now more than ever. The last few months have shown that our system is currently missing effective and necessary checks and balances to ensure that the fine line between proper incentive and destructive greed is not crossed.

While I firmly believe that the vast majority of today's corporate managers are smart and honest, it has been disconcerting to see so many unmasked not as captains of industry but as captains of greed with callous disregard for the welfare of the people whose money grows their companies.

Simply put, where I come from, we know that the fox cannot guard the henhouse. No matter how honest, no matter how well-meaning the fox, at some point the temptation to gouge is going to prevail.

Without proper regulation, history has shown, that hardworking Americans always pick up the tab: the Great Depression; the savings and loan debacle, which I served as a Federal white-collar prosecutor during that and we didn't have anywhere near the resources to do it right 10 years ago; and most recently, what you're dealing with, the power shortage in California.

In carrying out my fiduciary duty to the 600,000 beneficiaries in my funds, last month, with Eliot Spitzer's help, we began to be more aggressive owners. In conjunction with the Treasurer of California, Phillip Angelides, and the Controller of New York, Carl McCall, we announced important investment protection principles. These proposals embodied simple, common-sense market-based solutions to some of the problems that we face.

We as owners are exercising our ownership rights. We're putting new terms on the table. If you want our money, this is what we've got to have from you. We are demanding that broker-dealers and money managers eliminate actual and potential conflicts of interest from the way they pay their analysts and conduct their affairs, or we will no longer do business with them.

We are asking our money managers that we utilize to look closer into the areas of financial transparency and corporate conduct. But we, once again, need your help.

As fiduciaries, we must and will become more assertive in our ownership role. Since we've announced these principles, we have been joined by numerous other States and numerous pension funds. We now have almost \$700 billion backing this simple set of principles. And I believe, with your help, we will make a huge difference.

One final thing: In some areas, we need specific prohibitions. And I believe, Representative Gephardt, what was announced yesterday and what's been going on with the

Sarbanes bill will go a long way toward answering those problems.

In other areas, where specific prohibitions may be unwise, do make disclosure standards tougher. If you're having a tough time with options and other issues, do just as you've done in cigarette packaging, food labeling: make it, in a prudent and appropriate way, required that certain financial information be prominently displayed in plain language in proxy statements and annual reports.

If you will help the large and the small investor alike learn how to find the information needed to properly price option overhangs and option run rates, we as the market will go a long way in ridding ourselves of truly abusive practices.

I would also urge you to take a closer look at the difference between defined benefits and defined contribution plans. I think we went way overboard on defined contributions.

I run them both in North Carolina. I was stopped by groups yesterday, one retired school teacher in particular, who had \$300,000 in her 401(k) that is now worth \$120,000. She was in tears, and she was thanking me that the management of the traditional retirement fund that I also ran had not suffered anywhere near those kinds of losses, because we were properly diversified.

I appreciate the opportunity to be here today. And in closing, I must say that I was taken aback by the President's comments a couple of days ago that this was nothing more than a hangover. For many citizens, the people who I have been entrusted to protect, maybe unlike the executives at these companies, they won't be fine by lunchtime. It's going to take years and years of financial rehab for them to be back to normal.

Thank you.

Mr. GEPHARDT. Thank you, Richard, very much. You gave very eloquent testimony, as did Eliot. And I really appreciate you taking the time to be here.

We're now joined by William White from Houston. As I said, he has a distinguished career in the public and private sector. Thank you, Bill, for being here, and we're ready to hear your testimony.

STATEMENT OF WILLIAM WHITE, CEO, WEDGE GROUP

Mr. WHITE. Mr. Chairman, and distinguished Members, I've really looked forward to this because of the perspective that I'll share with you.

I'm blessed to run a number of large businesses. Not only do we own private firms, but we are the first or second largest shareholder in five public companies, where our stakes range from 9 to 60 percent. Some businesses I've built, and we've been pretty successful by any financial measure.

In a prior life, before I started in the private sector, for more than a dozen years, I was a public interest lawyer, specializing in accounting fraud and securities fraud, including getting the largest verdict and judgment in Federal securities law history against an accounting firm.

I've served on the board of a number of public companies, many on the New York Stock Exchange.

And so you can appreciate that I've been thinking about some of these issues a little bit. And I want to tell you, Mr. Chairman, this is a serious issue, this issue of confidence and the reliability of our financial system. It's not something that we can just sweep under the rug, and I'll tell you why. Because of the chronic trade deficits that this country has—it's the way that our economy has operated for a long time—we depend in this economy, for its strength and its growth, on being able to attract international investment to our economy. If that slows down, we're in a very serious situation.

And one reason why we get that foreign investment is because we are a Nation of laws, and we are perceived to have a transparent and fair financial system. Moreover, as the outstanding witnesses have pointed out, we do right now rely very heavily in our pension and retirement system on the individual savings and investments of ordinary Americans.

We, the people of the United States, do own the public companies, when you look at the distribution of stock ownership.

And during the period of the 1990s, there was an amazing transformation as so much household wealth was built up, and the increased worker productivity, and savings and wealth in our families.

If we do not have confidence in this system, it is the most serious problem that I can think of in our domestic economy for a long time.

So let me share with you a thought about our response to this and, if nothing more, a way to look at this. I'll be happy to answer questions on some specifics that I have, but my statement focuses on an approach, if you will, because this could take awhile for us to develop, not just instant legislation. But in the future, we need to be thinking about these things.

Now, we can't exaggerate the abuses. There are a lot of good people who are executives and in management in the American system. More than any other country in the world, people have worked their way to the top. Our ancestors all came here with nothing, and that's true with corporate executives, many of whom have worked their way to the top through hard work.

But this is more than a case of a few bad apples. I think what you've had is a crisis of leadership. What does leadership really mean? In business or in politics or in our families and churches, leadership means giving more than you take. Leadership means giving credit to others and being first to accept responsibility. Leadership for corporations should mean holding yourself as a CEO—and I'm a CEO—to a higher standard than anyone who reports to you. That's what leadership is. It is servant leadership.

And too often we've had a situation in this country where CEOs and corporate leaders take credit for whatever happens good in their company. And then when something bad happens, it's the fault of somebody else or the economy or the press.

Let me give you an example of that. I was with somebody who was an hourly worker on a factory floor, and we were having a discussion about some trade legislation. Now, I will tell you that I'm an advocate for freer trade legislation, and this person, who is a friend of mine, disagreed with me, and I was probing this difference. And this is what he said to me, he said, "Every time my company announces that there are good earnings or higher profits, it's because of management's strategy and plans, and they get multimillion dollar bonuses. But every time our profits and earnings have gone down, it's because of foreign competition, and workers are fired and bonuses are cut on the working people down the line."

So it's a good example of where we've had a failure of corporate leadership. Leadership does not mean giving yourself bonuses and making yourself wealthy when the organization you're leading is performing poorly. And it doesn't mean failing to accept responsibility when things go wrong, and that includes legal responsibility.

Mr. Chairman, as someone who has both sat on corporate boards and led corporations, and also enforced our existing securities laws in courtrooms before juries of Americans, I want to tell you that laws are important. Values are important. Ethics may be even more important than laws and values, but laws are important.

And it's simply not true that they will stifle the free enterprise system.

Look at the difference between this country and Russia, and I'll give you an example. I served in the administration and have had different private business dealings in Russia. Russia in the 1990s had democracy. There was freedom of expression, a lot of freedom of expression. There was free enterprise. But what there was not were laws and fair enforcement and impartial enforcement of those laws regardless of whether somebody is wealthy and powerful. And that's why their economy went down.

So it's every bit as important for this country as any other country. Strict enforcement of laws does not destroy the free enterprise system. Good business ethics and strong laws are the underpinnings of a successful market economy, as we've seen from nations across the world when those very things are lacking.

I'd like to make two final notes, Mr. Chairman.

One is about my own business community of Houston, Texas. For a while there, looking at the television or reading the newspapers, somebody might have thought, "Oh my gosh, what's going on in Houston, Texas? Is there a problem with business ethics in that one community?" And it's a community of which I'm proud. But we found that it's not just a matter of one community. It's not just a matter of one industry. It's something that's occurred systematically throughout a number of companies in our economy.

And I want to tell you, we can't stereotype a community. We can't stereotype an industry. We can't stereotype CEOs. The Democratic Party is a party that has fought stereotypes in all the best days of its existence. But we've got to start with business ethics and values, and reinforce those with strong and predictable laws. This is something that's affected workers and communities throughout this Nation.

And, Mr. Chairman, in the questions, if people have specific questions, I'm prepared to address issues concerning the governance structure of corporations, pension reform, avoiding conflicts of interest. And just on that, there's usually no good reason for an institutionalized conflict of interest, okay?

And fourth, how we rebuild the accounting profession, because it's not just what we do with accountants who are wrong, but how do we rebuild an accounting profession so that we have professionals who can enter this profession with dignity and respect?

On all those issues, the one that may be with us longer than many people suspect may be this issue of pensions and retirement plans. Many people have had unrealistic expectations not simply about what would happen when their 401(k) was invested in something bad, but whether their 401(k)s currently are sufficient. There have been surveys about this. Americans who are busy going about their daily work, and who read financial planning journals or watch the TV programs, may think that their \$80,000 401(k) may provide more retirement security than its worth.

There was a survey of individual investors in 401(k) plans concerning what their expectations of returns were. Over 20 percent of them thought they were going to be 50 to 100 percent a year, and another 20 percent thought they were going to be over 20 percent a year.

And corporations, as Warren Buffet, no socialist, has pointed out, have systematically overstated the returns on their pension investments. They're not making conservative assumptions concerning their returns on pension investments. If those assumptions were made more conservative, those pension funds would be underfunded.

These are issues that I hope this Congress can address. Thank you, Mr. Chair.

PANEL II: THE SEC, ACCOUNTING INDUSTRY AND ECONOMY

Mr. GEPHARDT. I'd like to first thank our distinguished former Federal Reserve Chair Paul Volcker for appearing here today. You all know that he is not only a brilliant economist, but he also has loads of realistic experience in all the areas we're focusing on today. And we're glad to have him with us and have his expertise on these issues.

Lynn Turner is a front-line fighter if there ever was one. He learned these issues inside and out from 1998 to 2001, when he served as chief accountant for the Securities and Exchange Commission. He fought with Arthur Levitt to strengthen the SEC's enforcement hand to go after companies that wrongly puffed up their earnings. And through his voice and leadership, he successfully shined a spotlight on these issues in recent months. And we thank him for his service and for being here.

Bevis Longstreth was an SEC commissioner under President Reagan, where he focused on all the issues that we're talking about today. More recently, he served on independent panels focusing on auditing effectiveness. He's been a professor at Columbia Law, written numerous articles, published a book on investment management, and he's a true public servant in every sense of the word.

Nancy Smith has considerable experience from her time at the SEC. As director of the Office of Investor Education and Assistance, she worked closely with Arthur Levitt. She's worked in the House of Representatives, which is always a good idea to us, where she focused, among other things, on the SEC and issues of accounting and corporate conduct and standards. And finally, she has a Web site, RestoreTheTrust.com, where investors are able to e-mail their Senators and ask them to support the Sarbanes bill to reform the auditing industry.

We're very pleased to have this panel. This is a distinguished panel, and I know they are all on a tough schedule, and we deeply appreciate their willingness to come here and be with us.

Paul Volcker, thank you for being here. It's good to see you again. You look great, exactly as you did when I last saw you here some years ago, so you're doing something right.

Mr. VOLCKER. I'm afraid I've gotten older. Mr. GEPHARDT. I doubt that.

STATEMENT OF THE HON. PAUL VOLCKER, FORMER CHAIRMAN, FEDERAL RESERVE BOARD
Mr. VOLCKER. You will be relieved to know, I hope, that I have no prepared statement that I will belabor you with. I did give a long speech on this problem at Northwestern—ironically, in the Arthur Andersen Hall—about accounting and auditing. And I had a rather dismal story from the standpoint.

It's clear that we face not just an individual problem but something of a systematic problem with this rash of difficulties in auditing, accounting, corporate governance, conflicts of interest in investment banking, which are not exactly a new phenomenon but which have shone brightly in recent months.

My message to you is very simple, that there is a clear need for action. But the priority at the moment is that bill you are getting, from the Senate, the Sarbanes bill, which is directed, I think, at an acute part of the problem in a realistic way. It is the reflection of some considerable hearings and discussion in the Senate and elsewhere. And it deals particularly effectively, I think, with two problems related to the fact that the auditing industry has chronically been unable, I think, to regulate itself despite many efforts over the years.

It would provide a strong oversight body with the kind of discipline and powers that I think are necessary, somewhat analogous to what we've been used to for many years in the securities industry itself. In that sense, it's not a radical change, but it is certainly a change that I think would bring needed discipline to the auditing industry that has been under great pressure and has not handled that pressure, frankly, very effectively.

And secondly, it deals with what I believe and what many other people believe are obvious conflicts of interest in the practice of auditing by removing large elements of the consulting practice from the auditing practice.

And I think the combination of those two remedies will go a long way toward providing a kind of backbone of professionalism intent in the auditing profession that's necessary to bring some of the problems that we've seen so evidently under control.

I would urge you, given that priority, that bill which will be before you in conference that deals with those problems in a rather comprehensive way, that you should go ahead and get that enacted as rapidly as possible without too much extraneous additions, subtractions, or whatever.

I think in part, in that connection, on the question of stock options, which has attracted a lot of attention, I am not a fan of stock options. I think they have been more abused than used in any appropriate way. I think they give very capricious results. They often reward the unjust and don't reward the just in terms of their effect on the market. But this does not seem to me the time and the place for the Congress to command particular treatment. There are bodies that have that under review.

I am the chairman of the board of trustees of the International Accounting Standards Committee, which appoints an international accounting standards board. Its overall effort is to get some commonality, some convergence, in accounting standards around the world. By coincidence, yesterday or the day before, they sent out for public comment their proposal for the expensing of stock options. But whether it's the international board, which is obviously at work, or FASB, our own board, it seems to me that the way that is treated is a technical matter which we ought to leave to the accountants and the board.

And I have to remind you, the last time Congress got interested in this subject, about 8 years ago, they took the opposite position and, in effect, overruled what the accountants wanted to do and prevented the expensing of stock options. So I would suggest that that problem will be dealt with in an appropriate way in a quite different atmosphere today.

I think your priority ought to be to deal with the bill in conference, with the bill that has passed the House, but make sure that what comes out of that does achieve the essential purpose of a really effective oversight board for the profession and deals with that conflict of interest and also deals with some other matters as well. But I think that is the essential part of that bill that should be preserved and enacted as soon as you can manage it.

Mr. GEPHARDT. Thank you very much. We appreciate you taking the time to be here.

Lynn?

STATEMENT OF LYNN TURNER, FORMER CHIEF ACCOUNTANT, SECURITIES AND EXCHANGE COMMISSION

Mr. TURNER. Thank you, Congressman, for inviting me here. It's actually great to be back in D.C.

I just flew back in from the West where I had actually gone out fishing in the back-

woods, if you will. It was interesting, as I got a call about the hearing last week, and I was literally walking out the door with my fly-fishing rod to get away from what seemed to be an all-consuming issue here.

And we got out on the river the first morning with the guide, and keep in mind that we're in a place where there's no New York Times, no Washington Post, no Wall Street Journal, even the BlackBerry wouldn't work.

The guide asked, "What do you do for a living?" And I said, "Well, I'm an accountant." I admitted it. I figured I was safe. I mean, no papers, not even a daily paper. And he turns around and he looks to me and he says, "You know, you guys aren't doing very well these days. Have you considered a career change, Mr. Turner?" [Laughter.]

And so I spent 3 days on the river with this guide. So it's nice to be back to civilization. [Laughter.]

But I think what that points out, though, is that there a lot of Americans in all necks of the woods out there that are very concerned about what has transpired here and how it has impacted them and their savings and their families, whereas maybe 10 or 20 or 30 years ago, it wasn't as important as it is today, given that there has been a significant change. We now have 85 million Americans in the markets, either in stocks or mutual funds; that's one out of every two voting Americans. That's significant.

And they had a third of their wealth at the height of the markets tied up in the stock market. For the first time ever, it was more than they had in the equity in their homes. So the amount of damage that can be done if we don't get significant reforms is quite incredible.

If you think about Enron itself, the losses were twice what the losses were from the unbelievable tragedy of 9/11, six times the losses Hurricane Andrew when Miami was wiped out, in just one of these tragedies.

So it is as important, as Chairman Volcker said, that we get this thing fixed.

But the facts are in today. And in 2001, we had a record number of restatements, 270 restatements; 1,089 over the past 5 years. These numbers really do prove that there are more than just a few bad apples out there in the orchard, if you will, that President Bush would have led us all to believe in his speech last week.

And the accounting profession's refrain that we've heard for years and years here in this building, that 99.9 percent of the audits are okay, is also no longer credible, when you think about the fact that Rite Aid and WorldCom and Xerox and Enron were all part of that 99.9 percent at one point in time.

And also, the accounting profession would like you to think that, dingdong, the witch is gone now, with Andersen falling by the wayside, despite heroic efforts by Paul Volcker to save that firm, and that they were really the problem. But that isn't true. If you look Rite Aid, it was audited by KPMG, as was Xerox; MicroStrategy and WR Grace by PricewaterhouseCoopers; Deloitte did Adelphi; and Candiant was done by Ernst & Young.

So each of the firms, and certainly this was my experience at the commission, had their problems. And they were significant problems. The auditors have been investing the cash that they generated from a very profitable audit practice into the consulting practices. They've been writing broad principles-based auditing standards that have been so general that an independent panel chaired by the former chairman of Pricewaterhouse, of which a member was former Commissioner Bevis Longstreth here to my right, they issued 200 recommendations to the profession. To date, many have yet to be implemented as noted in a GAO report of just the last month or so.

So the profession itself has not done very well. And in fact, on some of these audits—if you looked at the audit of MicroStrategy, the problems there were detected in a magazine article that was written about their accounting. And the problems on Rite Aid were detected by a desktop review by an SEC staffer. And it's phenomenal that, on WorldCom, an internal auditor can find the problem that the external auditors never found. On a case like Rite Aid, a desktop review hundreds of miles away found a problem that couldn't be found on site. And in the case of MicroStrategy, a business article turned up something that people onsite couldn't find.

And at the same time, as we heard from Attorney General Spitzer, certainly the analysts have been a big problem. They've been rewarded for doing marketing rather than analysis, it seems, which the investment bankers, quite frankly, appreciated, as they saw themselves boosted by the analysts' exaggerated research reports and road shows.

And I'd be remiss if I said—during the last 3 to 4 years, as Chairman Levitt tried to get some of the reforms enacted, that some Members of Congress also opposed and vehemently opposed some of those reforms.

And if it wasn't for some people like Congressman LaFalce and Congressman Markey, whose support was absolutely fantastic and wonderful as we fought those battles—in fact, I don't think Arthur or I could have survived if it hadn't been for the support that we got from those Representatives.

We did get some reforms done, but certainly not as many as should have been done at that point in time, given the problems that were out there and problems that were ignored by other Members of Congress who, quite frankly, could have stepped in, I think, at that point in time and help fix the problem.

As Paul Volcker mentioned, I do think the solution here is in the Sarbanes bill. Congressman LaFalce had a similar bill here in the House that unfortunately the Republicans didn't give the Democrats a chance to bring to a full thumbs-up or thumbs-down vote. And I think Congressman LaFalce's bill, much like Senator Sarbane's, is one that provides a systemic solution for what is truly a systemic problem.

But now with the Sarbanes bill, it is my hope that, through conference, we'll get that bill out without weakening it. So while it may not have the LaFalce name on it, it will have the LaFalce intent and heart behind it.

We need to ensure that we have an adequately funded and independent SEC. The funding, there is no question that the handcuffs that were put on us at the SEC prevented us from doing our jobs. When I walked into the SEC in July of 1998, we had a total of 15 accountants to do all the enforcement cases against 240 enforcement cases at the time. They physically were not able to do it.

And in fact, as we went through those enforcement cases, we knew we had a number of good cases that, quite frankly, we had to drop and couldn't prosecute, because you just didn't have enough hours in the day. And that was directly due to the lack of funding, that we had received and the handcuffs that had been put on us. So we need to get that fixed.

We need to allow them to have enough people to review the filings last year. There was one staff accountant at the SEC for each 1,000 to 1,100 filings that come in. Many of these filings are a foot thick. So, again, physically, you can't work enough hours in a day. Unless you extend the days by an act of Congress to about 48 hours, we're just not going to be able to get the job done with \$776 million in funding in the Sarbanes bill, which is sorely needed.

And it's interesting to note that finally this administration and Chairman Pitt are coming around and starting to look like they might support some additional funding, which is great. I only wish they had done that when they submitted their original budget to Congress in February, which actually reduced the number of budgeted positions for the SEC well after Enron and Global Crossing had come to light.

We also need to make sure that we get adequate funding for the Justice Department. It is the Justice Department that has to bring all of these criminal prosecutions. The SEC will not bring one of those. And as the guide on the fishing trip said, he wanted to know, would we see these people, if they're found culpable of a wrongdoing, brought to justice. Well, the only way they'll be brought to justice is if we give Justice the tools and resources to do it. Absent doing that, we might as well turn around and put a 55 mile an hour speed limit sign out there on I-95 with a sign about 5 feet behind it, saying "No police for the next 100 miles." And you know everybody is going to be in the fast lane.

That's, in essence, what we're doing with the Justice Department and the SEC, unless we give them additional funding.

As in the Sarbanes bill, without a doubt we need to increase and improve upon the independent auditors, banning them from providing the services that really do impact their economy, regardless of size. It doesn't matter if it's a small company or a big company; you need to have integrity in the financial statements.

We need that strong oversight board. Restatements of the magnitude of \$3.8 billion on WorldCom and \$1.6 billion on Rite Aid, \$6 billion on Xerox—as I tell my students in class these days, if you can't get the numbers any closer than the nearest billion bucks, you're not going to pass this class. [Laughter.]

We need to get that fixed. That board needs to have the ability to set the standards by which we measure the performance of the auditors. The auditors I know have been up here saying, "Well, if you don't have auditors doing it, how can you get good standards?" Well, Congressmen, we've had knowledgeable standards written by knowledgeable auditors for the last 60 years, and it hasn't got the job done. What we found is those knowledgeable auditors have been writing standards that protect their interests in case of litigation and have dismally failed to protect the interests of investors and the integrity of numbers.

And as for the analysts, as Attorney General Spitzer said I think very eloquently, we need to go further than President Bush proposed when he suggested sticking with the rules the stock exchanges have already adopted. Those rules absolutely fail to provide analysts with protection from the very retribution of executives and underwriters who might be displeased by a negative research report.

We need to definitely strengthen the corporate governance. It has failed us. We need good, independent corporate boards, just like we need good, independent analysts and good, independent auditors.

And finally, we need good, independent accounting standard-setters with adequate funding and trustees who are representatives of the public, not trade organizations.

It's interesting to note that former Chairman Volcker brought up the issue of stock options. As a former executive, I actually think stock options can be a very good tool, if used properly and governed right within a corporation. There's nothing wrong with that. But I hear people say, "Well, you can't adequately measure them." Having been an executive of a large, international semicon-

ductor company, I would tell you that if an executive can't figure out what he's compensating employees, including with the stock options, if he can't measure them, he shouldn't be an executive there in the first place.

We all participated in the same surveys. We all knew what they were worth. And we all turned around and calculated that number using standard methodologies. It can be done. And people just need to put their heart behind it and get it done. In fact, a survey of approximately 2,000 analysts last year showed that 80 percent of them feel that the accounting standards for stock options are deficient and don't provide them enough information to do their job. We need to fix that so that the analysts can get the job done right and so investors can make informed decisions.

And the market I think has responded to President Bush's call for a crackdown on corporate fraud, but it has rejected his proposals as too little, too late, when it was shown in the market to where it dropped over 400 points in just the first 2 days after his speech before I went on my fishing trip. And since then, I've seen it's dropped more.

Legislation proposed by Senator Sarbanes advances the ball much further than the President's plan or the legislation the House has adopted or the proposals from Chairman Harvey Pitt. Sarbanes' bill is the only one to ensure the independence of auditors, corporate boards, and analysts. It provides effective and timely discipline, and it offers the funding necessary for the SEC and accounting standard-setters to do their job. It's a good start to solving what ails the market.

Congress needs to find the will to pass it without weakening it anymore, and send it on to the President. And if not, I can tell you that I've heard many an angry American investor that says they will vote for reform in November.

Thank you.

Mr. GEPHARDT. Thank you, Lynn, very much.

I failed to ask you if you caught any fish on this trip. [Laughter.]

Did he take you to anyplace where you caught anything?

Mr. TURNER. We did very well.

Mr. GEPHARDT. Good. Well, we'll try to get this bill passed so that you can retain his confidence and he'll take you back. [Laughter.]

Professor Longstreth, we appreciate you being here, and we're ready to hear you.

STATEMENT OF BEVIS LONGSTRETH, FORMER MEMBER, SECURITIES AND EXCHANGE COMMISSION

Mr. LONGSTRETH. It's a pleasure to be here. And it's a pleasure to be in this room. The last time I testified on this subject before the House, it was in the House Commerce Committee, and I was so far away from you, I wasn't sure you were really there. [Laughter.]

So this is a very intimate gathering, and I appreciate the chance to communicate.

S. 2673, the Sarbanes bill, is a critically important piece of legislation that, in my judgment, should be passed by the House and placed on the President's desk without delay. Nothing I can think of would do more to restore the public's trust in our financial markets than the simple adoption by the House of this bill, and make it the House's own bill.

The need for this bill to become law transcends party. To its credit, the Senate confirmed this fact by its vote of 97-0.

While my roots are in the Democratic Party, what I want to say today is intended to be completely bipartisan. I would say precisely the same thing if this were a Republican Caucus. It's designed to appeal to both

sides of the aisle and to get the objective I just stated done.

There's much to applaud in the Sarbanes bill. But I'm going to concentrate on the very heart of that bill, the most important parts of it, which should not be compromised and must be adopted. These measures I'm going to talk about relate to the creation and the empowerment of an oversight board to regulate auditors of public companies.

For decades, the auditing profession claimed that despite the obvious conflicts of interest it could effectively regulate itself. It has now become evident to just about everybody in the country, outside a tiny circle of leaders in that profession, that self-regulation has been a failure. It's not a new failure, for it has never worked. But the failure now is of such magnitude in terms of cost to the investing public that it can no longer be ignored.

It's not being ignored by the SEC. In its recent release proposing a public accountability board, it based that proposal on a scathing account. I was shocked and delighted to read the scathing account in that release on the profession's efforts over decades to self-regulate itself.

The Wall Street Journal quoted Chairman Pitt as saying, "The era of self regulation by the accounting profession is over." So the SEC is basically on board with Sarbanes in that statement and in that release.

The OMB, for its part, on July 9, in its statement of administration policy regarding Sarbanes, said, "A two-tiered regulatory framework is necessary to protect investors." That's not what Congressman Oxley seemed to be saying as of 2 days ago.

And the OMB went on to conclude that "a newly established, independent accounting oversight board should set, oversee, and enforce professional audit, quality control, and ethics standards."

Now, we have the Senate, and they've spoken to the same effect and in appropriate detail with care, clarity, and the force of unanimity.

So now it's the House's turn. And with all this agreement afoot as to the need for an effective oversight board, one could reasonably ask, what's the problem? Why are we here? The problem is found in a very fundamental difference of opinion as to what it takes to assure that the oversight board will be effective.

Chairman Pitt and the administration believe the SEC itself could create an effective board by administrative action. Professors Coffey and Seligman and I strongly disagree, and the specifics of that disagreement are in a letter that I am going to attach to this testimony to give you. We gave that letter to Chairman Sarbanes.

The Oxley bill was passed some time ago, before WorldCom created a tailwind behind real reform. And it is woefully deficient in arming the oversight board with powers sufficient to permit it to function effectively.

Now, I think everyone would agree that effectiveness in creating any government agency is essential. It's not useful to spend taxpayers' money on going through motions that don't accomplish anything, *ab initio* don't have a prospect of accomplishing anything.

Nothing could do more harm to investor confidence than the passage of a bill that has only a patina of reform allowing legislators to claim victory when in fact it fails to provide the tools needed to get the job done. An already skeptical public can be counted on to punish anyone engaging in that kind of sham.

Without going into detail on Oxley, let me mention a few of the most glaring problems. Oxley would allow the profession to control the oversight board; it would allow the pro-

fession to control the oversight board. That's the same defect that is in the Pitt proposal in the administrative version. And we pointed that out in our letter.

In reality, the Oxley bill as it is now written would simply dress in new clothes the failed system of self-regulation. Watchdogs selected by those whom they are intended to watch will do nothing to restore investor confidence in the audit function. To the contrary, it will further erode it.

Second, Oxley would not assure funding for the board free of influence or control by the profession. In the past, this profession has not hesitated to withdraw funding from entities itself had created to carry out self-regulation when those entities dared to do something that the profession didn't like.

The third point: Oxley would deny the oversight board the power to prohibit a firm from providing non-audit services to its audit clients. Even the nature and/or amount of such services would impair the auditors' independence.

In his testimony before the Senate this week, Chairman Greenspan said, wisely, I think, humans haven't become any more greedy than in generations past. He said the problem was "that the avenues to express greed had grown so enormously."

And indeed they have. As applied to the audit profession, the immense growth in non-audit services has become a super-highway for the expression of greed. Today over 70 percent of all fees paid by public companies to their auditors are for non-audit services. For the oversight board to have a chance to be effective in taming the profession's infectious greed, to borrow the chairman's newly minted phrase, the board must have the power to prohibit non-audit services.

The fourth point: Oxley fails to grant the oversight board adequate investigative enforcement and disciplinary powers. Without a set of powers at least comparable to what the NASB and the New York Stock Exchange enjoy with respect to broker-dealers, the oversight board is doomed to ineffectiveness.

There are lots of other deficiencies which a careful side-by-side comparison with the Sarbanes bill would quickly reveal.

I think a legislatively empowered oversight board is so important to restoring investor trust, transcendentally important in terms of the other things in that bill. The reason for that is found in the audit function itself.

Since 1934, public companies have been required to have independent public accountants vouch for their numbers. The auditors are the last line of defense against management's inclination to fudge the numbers. Unlike the companies they examine, auditors are simply not supposed to be taking risks. They're not entrepreneurs. And yet with the enormous growth in consulting and other non-audit services rendered to management, they became co-venturers with management to such a degree that their independence as auditors was often compromised.

They put themselves in a severe conflict of interest when they perform non-audit services, on the one hand trying to woo management to be retained to perform highly profitable services that management could easily procure elsewhere, while on the other hand trying to serve the audit committee and the company shareholders by being questioning and skeptical of management in reviewing the numbers.

The cause and effect of allowing this conflict to persist any longer is no secret, even to those untrained in finance. Listen to what R. L. Butler, a retired clergyman in Denver, said, as quoted on the front page of the New York Times yesterday. "The worst thing now is you can't even trust the earnings reports.

When you find the auditors in bed with the managers, there's nobody to believe."

Mr. Butler understands this, and so does a rapidly growing number of very angry investors who have lost much of their life savings in stock markets and all of their faith in audited numbers.

And these people vote. They want their trust restored. Congress has a chance to accomplish that, and it can be done through legislation, ensuring a system by which companies present their financial condition and that that system is worthy of trust.

S. 2673 is the vehicle. It's sitting there ready and waiting. My dream is to watch bipartisan leadership in the House get behind the wheel, drive that vehicle over to the White House, and park it on the President's desk.

Mr. RANGEL. Thank you, Mr. Longstreth. That's our dream, too.

Those bells indicate that there is a vote taking place on the floor. In the interests of time, this hearing will continue. Members can vote and return.

But it's my privilege to recognize Ms. Nancy Smith. And thank you once again for taking the time to share your views with us.

STATEMENT OF NANCY SMITH, FORMER DIRECTOR, INVESTOR EDUCATION AND ASSISTANCE, SECURITIES AND EXCHANGE COMMISSION

Ms. SMITH. Thank you very much. It's a pleasure to be back in the House of Representatives and see so many faces that I remember from when I worked here. And thank you for inviting me to be on the panel today.

I am the director of the RestoreTheTrust.com. RestoreTheTrust.com is a nonpartisan campaign dedicated to educating the public about accounting reform and to make sure that real reform is signed into law. The Web site was created to give individual investors a place to go to learn about what is at stake and to voice their support for the only true reform proposal on the table, the Sarbanes bill.

At the Web site, you can send an e-mail in support of the Sarbanes bill and real reform to your Members of Congress, the President, and SEC Chairman Harvey Pitt.

We launched the Web site just weeks ago on July 1. In that short time, individuals have sent 46,000 letters in support of the Sarbanes bill to decision makers.

Individual investors have suffered enormous losses because our lax regulatory system overseeing auditors let them down. We hear from investors who have suffered enormous losses. Some retirees wonder how they are going to make ends meet now that their retirement funds have been slashed by a third or more.

To say people are angry is an understatement. People expect the market to go up and down. As one investor wrote to us, "I can understand losing when things like the economy and certain markets sour. But now I'm losing largely because the information on which I depended turned out to be false. I guess I was naive. I thought the American system of corporate reporting was basically honest."

We all know that restoring trust in our stock market is critical. The health of corporate America, their ability to raise capital and raise jobs, drives the well-being and financial security of every American. When investors don't trust corporate America to tell the truth about their financial health, it means investors don't give corporations the money they need to grow and prosper. And as a result, our economy suffers.

One investor who wrote to us brought this point home. "I will not invest any more of my hard-earned money to line the pockets of thieves."

It's imperative that we make sure the numbers tell the truth and that people believe they are truthful. So how do we do that? Increasing penalties for lying and stealing, and sending corporate executives and their auditors to jail, sounds great. But strong enforcement is only half the answer. You can't pay the mortgage or the grocery bill with the satisfaction of seeing some tycoon sitting behind bars. We must prevent these accounting frauds and the losses they cause from happening again.

It's unbelievable that we let the auditors police themselves. The lax regulatory system we have in place today has got to go. It needs to be replaced by the sensible and effective regulatory system in the Sarbanes bill that provides independent oversight of the accounting industry and prohibits auditors from consulting for the companies they audit.

The litmus test for true reform is twofold: create a full-time independent board free from industry control to oversee auditors and punish wrongdoers; and, two, restrict auditors from providing lucrative consulting services to the firms they audit. Auditors should not be tempted to get cozy with management. They can't get consulting fees and fight hard for audits that protect investors.

The Senate bill is the only bill to restore investors' trust and prevent future scandals. Investors want real reform in the Senate bill, and they want it now. They will know if any backroom deals allow industry lobbyists to water it down.

There's a basic problem with the House bill, the Oxley bill: It doesn't meet the litmus test, and it doesn't fix the problem. There's a reason the accounting industry supports it over the Senate bill; the House bill keeps the accounting industry firmly in control.

We've learned a costly lesson: When the accounting industry polices itself, they get themselves and investors in big trouble.

The auditors cooked the books; don't let them cook the legislation. The House bill is just a warmed-over version of the status quo.

There's no time to waste. The Senate voted 97-0 for a bill that gives us a sensible regulatory system that is designed to work. Let's follow the lead of Democrats and Republicans in the Senate and get the Sarbanes bill to the President for his signature right away.

Thank you very much.

Mr. GEPHARDT. Let me ask one question, and then we'll end.

And, again, I deeply appreciate all of you being here. I wish all of America and all these investors that we worry about here could have heard this panel. I think their confidence, just by hearing you, would have been enormously restored.

It's always reassuring to me, as a citizen of this country, that we have people like each of you, who is willing to give a large part of your career to public service, so that the greatest system that's ever been devised in the history of the world of democracy and capitalism can work properly. So I hope to get your testimony out to as wide an audience as we can.

My question is really a follow-on. I think Paul's answer is what I certainly agree with, that we've got this thing in front of us now. It got a unanimous vote in the Senate; that rarely happens. So we have to seize the moment and try to get this bill through without interrupting it or diluting it or changing it dramatically and watering it way down.

My question is this: Do any of you think that further legislation, assuming we get this done, on the stock option question—Paul talked about it, and I think Lynn talked about. And I understand that the International Accounting Standards Board made a recommendation today or yesterday.

Mr. VOLCKER. More than a recommendation.

Mr. GEPHARDT. Yes, they did it.

There is, I'm told, a Levin-McCain bill now that would ship this off to the new independent board, or the FASB, I'm not sure which, and ask them to reconsider a lot of rules and to come back with recommendations within a year. I'd like to have your thoughts about that.

And I'd like to have your thoughts about the pension issues, profit-sharing issues. Some of those George Miller brought up. Do you think that we should try to get a bill done there? We did do a bill here. It had some deficiencies in it, from my viewpoint. The Senate is going to try to deal with it. What do you think is the heart of anything that needs to be done in that area, if anything?

Those are the two questions.

Mr. VOLCKER. Well, on the pension side of things, let me say that I think there probably is a need for some legislation there, in order to better protect the pensioner himself. But that is a classic case of something has its own complications and should not be added to the current bill.

Mr. GEPHARDT. Right.

Mr. VOLCKER. I think that is something you have to think about a little more, about how to do it. But I think there is good reason to proceed.

I am not so sure about the stock option question. I think we have a designated arrangement for dealing with that question. It's hard to object to a bill that tells FASB to reconsider it. I think they will reconsider it anyway, whether there's a bill or not.

My hesitancy is, I don't want to create a precedent that Congress is going to write the accounting rules. And that's—

Mr. GEPHARDT. That would not be a good idea. [Laughter.]

Take my word for it.

Mr. VOLCKER. That's what you would be doing in this particular case, and I don't want to see that precedent. I feel quite confident that the board that I am involved with—I may agree or disagree with the very specific action they take, but they have that problem well in mind. And they're trying their best to come up—they've expressed their view that it should be expensed. The question is how it should be expensed. And I would leave that question up to them, frankly.

Mr. LONGSTRETH. I have one comment on the stock options. I agree completely with Paul that Congress ought not to legislate either on expense or non-expense. And that gets back to the history of this. They really overruled FASB.

And I think FASB, once burned in that way, even with the present situation, may be reluctant to take it up. I have no expertise on that, but I think there are so many people in this country who argue strenuously, and they're bright people, and some of them are highly motivated people, for not expensing options. And I feel so strongly they should be expensed that I think that—I don't see a problem, Paul, with having the Congress undo the damage it did earlier by simply saying we encourage or even direct, but I think you could—a sense of Congress to invite and encourage FASB to revisit this issue would be, I think, a good idea, because it would give FASB the cover, the sense of direction, that they may need.

I mean, this market can turn around again, and the momentum will be gone. But it won't be gone for those people who have an enormous stake in hiding these numbers.

Mr. VOLCKER. I think it's a little naive to suggest that Congress could suggest that and pass such a law without it carrying the implication that you'll do this. And I don't think it's appropriate.

FASB will be forced to take it up if the international takes it up and passes it. I didn't say they're going to do anything, but they can't sit there. They're either going to have to say yes or no.

Mr. LONGSTRETH. Okay, that's a good point.

Mr. TURNER. Let me jump in between these two distinguished gentlemen and stay down low. [Laughter.]

First of all, back to the Sarbanes bill, quite frankly, this is a very, very simple issue: You're either for reform or you're not. You're either for the Sarbanes bill or you're not.

The Oxley bill, the Pitt program, and the 10-point President's program all have some good things in there, but they fall a mile short. They are not reform.

And I think the House could just vote for the Sarbanes bill. To have to beat this to death in conference and perhaps water it down is not being for reform. If the House leadership wants to demonstrate that it's clearly for reform, it will have the Members vote on the Sarbanes bill straight up and get it to the President's desk before the end of the week, tomorrow.

And I feel passion about that. This is very simple. America wants a simple answer. Let's just get reform. Let's get it down.

So I commend you, Representative Gephardt, for holding this hearing, because I think it's important that the public understands who is for reform and who is against.

With respect to the two pieces of legislation, again, having run a company where we had many employees, many pension programs, I would agree with Paul Volcker, that you should do some additional legislation there to protect the employees in those situations. Again, do it in a separate bill outside of Sarbanes.

As far as the stock option issue, the reason we're in the dilemma we're in, to some degree, is because of congressional interference with the FASB in the past. I mean, we would have had a good standard if it hadn't been for that interference.

So I do agree with Bevis Longstreth that it doesn't do harm, in this case, if you undid the damage that you did in the past. But you should not legislate what the accounting should be. I think to ask the FASB to put it on the agenda, and then let them go through their normal due process, is fine.

I saw earlier drafts of some legislation over in the Senate, though, where some people wanted FASB to conduct a study, but it was almost biased from day one.

I think if you asked the FASB to do something, it should be simple and should not have a bias. It should just be, "Would you consider putting it back on your agenda? And then go do whatever you think is right," and leave it at that, nothing more, nothing less.

I have been on panels with two of the members of the FASB where they have been very adamant. Given the tremendous fight and the difficulty that they went through the first time, both of these members vowed that they would not, absent some outside support, they absolutely would not put it back on their agenda, including if the ISB undertook the project.

And if the ISB undertakes the project and gets something out—as Paul indicated, the exposure draft is out there—and gets something done, I think that the opposition from the American business community may still present an obstacle to the FASB ever putting it back on its agenda, given what happened 8 years ago.

So I would have no problem, if you kept it simple. I think it would actually be good if you asked them to put it back on the agenda and reconsider it, because it may get us to

convergence on international standards, and that would be very helpful, as long as people let the process run the way it should turn around and run. And I'd encourage you to do that.

Mr. GEPHARDT. Thank you.

Nancy, do you have a last thought here?

Ms. SMITH. Well, I agree with what the gentlemen have said. I think the bottom line is the American people want to hear the truth.

And when we look at these issues, what our guide should be is: Are we telling the truth about these numbers? Are we shading the profitability of a company by what we're doing on stock options? That doesn't serve the investing public. That's what the investing public is upset about right now.

So let's restore the trust. Let's tell people the truth. That's all people want.

Mr. GEPHARDT. Thank you again. This has been a fabulous panel. I have really benefited from hearing you. You have enormous experience and practical advice to give us, and we have benefited from it enormously. And we'll try to get your testimony as widely spread as we can.

Thank you very much.

[Whereupon, at 4:00 p.m., the hearing was adjourned.]